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SUBJECT: Top economists' views on Guatemala

11. (SBU) Summary: Guatemalan economists generally agree that to address the country's socio-economic problems institutions must become more effective. However, for this the government will need more revenue, and tax increases have been repeatedly blocked by special interest groups, including business associations. Stronger presidential leadership would help, as would a reprioritization of budget earmarks. CAFTA will not break the power of those advocating the status quo, but could help establish policy continuity. End summary

12. (U) Recently we met with four of Guatemala's top economists, Jorge Lavarreda and Hugo Maul of CIEN, the foremost economic think tank, Pablo Rodas, frequent media commentator and former economic director of ASIES, the principal institute for social studies, and Juan Jose Arevalo, former Minister of Finance, President of the Central Bank and current university President and economics commentator for the leading daily La Prensa Libre. We queried them on their views on Guatemala's economy, in particular on how to improve socio-economic conditions and promote equitable and sustainable economic growth.

#### WEAK INSTITUTIONS

13. (SBU) Lavarreda, President of CIEN and director of its social policy area, stated that Guatemala's main problems are weak rule of law, poverty, low investment in human capital, corruption and insecurity. A first step to solving these problems would be to strengthen Guatemala's institutions, for example the Comptroller's Office and Congress. (Note: The Comptroller has responsibility for the efficacy and transparency of government spending, and was weakened by a corruption scandal under the Portillo administration.) In addition, the state must invest more in education, health, and sanitation. Pablo Rodas also stressed institutional strengthening and bemoaned the lack of a professional civil service to provide continuity between administrations. He added that there are too many ministries and state secretariats for a small country, many of which have become

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"feudal" chiefdoms. Arevalo also emphasized the development cost of Guatemala's weak institutions, and criticized the lack of technocratic expertise within the government. In the commercial area, he cited a similar lack of a solid professional class with the technical skills to compete in a globalized economy. (Note: Arevalo is a member of a free trade group that is seeking private sector and university support for more relevant training programs and educational career tracks.)

#### NEED TO INCREASE GOVERNMENT REVENUES

14. (SBU) Hugo Maul focused on the fiscal situation. Increases in government revenues are difficult because interest groups such as labor unions and private sector organizations have "captured the state" in order to preserve the status quo. Some labor unions are wedded to antiquated socialist ideals, while business groups oppose almost all tax increases. To increase revenues the government must carry out a more forceful political negotiation and improve transparency in the use of public funds. Rodas agreed that the Berger administration, while relatively honest and well meaning, has not effectively dealt with interest groups and Congress. He added that better enforcement and efforts to increase the tax base could help alleviate chronic government underfunding.

15. (SBU) Maul said that the tax measures and budget cuts (notably in military spending) of 2004 were emergency actions to compensate for revenues lost as a result of taxes suspended by the Constitutional Court. He explained that there are 800,000 workers registered in the Social Security Institute, but only 120,000 pay Income Tax. He is pessimistic about increasing government revenues only through better enforcement. For example, the government cannot control or eliminate the informal economy, since large numbers of people depend on it for their livelihood. In fact, most of the country lives almost entirely outside of the institutional framework, claimed Maul. Moreover, the tax authority (SAT) does not have the have enough resources for effective enforcement.

## CONSTITUTIONAL COURT AND NON-DISCRETIONARY ITEMS ARE PROBLEMS

16. (SBU) According to Maul, one solution to the fiscal problem is to better prioritize scarce government resources. However, this is difficult to implement since about 70% of the budget is earmarked through constitutional allotments. For example, public San Carlos University may receive no less than five percent of the total budget, sports no less than three percent, and the judicial system two percent. Rodas, meanwhile, complained about the competence of the Constitutional Court, which has frequently overturned new tax measures on dubious "constitutional" grounds of double taxation. He criticized the justices for being lawyers with no economic experience. This, he added, is also a problem in Congress.

## OUTLOOK FOR THE ECONOMY

17. (SBU) Maul appeared quite pessimistic on long-term improvements in the Guatemalan economy or the institutions that underlie it. He pointed out that population growth usually keeps pace with GDP growth, so per capita income, especially for the poor, remains stagnant. Rodas, on the other hand, proved optimistic, stating that there has been positive diversification of the economy. There are now several economic engines besides traditional agriculture. They include agricultural specialty products and increasingly services and industry, notably textiles.

## NEED STRONGER PRESIDNETIAL LEADERSHIP

18. (SBU) Nonetheless, Rodas and the CIEN economists were adamant about the need for more forceful executive action to address the country's pressing problems. If Berger wants a like-minded candidate to win the 2007 election, said Maul, he will have to take dramatic steps to improve the security situation and focus on visible infrastructure projects such as roads. The recent natural disaster gives him another chance to prove his leadership. According to Rodas, should Berger fail to instill public confidence in his administration it will leave the door open for more populist leaders such as Alvaro Colom, his challenger in the last election. Colom, said Rodas, is a "caudillo," who is disliked by the business sector. Concerning the effects of hurricane Stan, Rodas said that he has seen studies that suggest such calamities can reduce GDP growth rates by up to 2% in the first year.

## CAFTA

19. (SBU) The economists' views on CAFTA's ability to alleviate Guatemala's socio-economic problems were mixed. Maul believes CAFTA will not obviate the need for institutional reforms. Furthermore, well-organized and financed interest groups will not lose power, in spite of CAFTA. Rodas hopes that CAFTA will provide urgently needed policy continuity, since it enjoys strong enough support so that no major political group can challenge it. Arevalo agreed, pointing out that international treaties such as CAFTA are a good way of lessening economic policy discretion, which is too often manipulated for political purposes. CAFTA should help to lock-in progressive economic policies.

## COMMENT

10. (SBU) The four economists we spoke with all fall into the centrist mainstream and their views represent most commentators' thinking on current economic issues. None offered any dramatic new ideas on how to address the root causes of Guatemala's socio-economic ills - such as income inequality and low government revenues. The solutions, as promulgated by the IFIs and others - including the present government - are well known.

Derham